December 12, 2001

Defense Acquisition Regulations Council
Attn: Ms. Sandra Haberlin
OUSD (AT&L) DP [DAR]
IMD 3C132, 3062 Defense Pentagon
Washington, DC 20301-3062

Subject: DFARS Case 2000-D018
Reference: Federal Register: September 21, 2001 (Volume 66, Number 184)

Dear Ms. Haberlin:

Please consider the comments herein to the proposed rule, Changes to Profit Policy in DFARS Subpart 215.4. Comments regarding the need for change were provided to Mr. Bill Mounts, ODUSD (AR), three years ago. I have attached the letter to Mr. Mounts since it describes the adverse impact of current profit policy on contractors that restructure to meet defense marketplace realities.

The proposed change addresses the key points highlighted to Mr. Mounts, but could be improved. Suggested improvements are provided in a separate attachment to this letter.

The need to preserve the Defense Industrial Base is urgent. At Defense Systems we have a small, but growing commercial segment that achieves margins that are a significant multiple of margins realized in our government business. The need to supply highly skilled resources to both segments places considerable pressure on the lower margin business.

Please note that the comments attached represent the views of one business unit of General Dynamics, and are not intended to represent the entire Corporation.

Sincerely,

Gerald P. Wergland
Director-Contracts & Estimating

Comments on Proposed Rule DFARS Case 2000-D018

1. 215.404-7 l-2 Performance Risk – the standard range for composite performance risk is capped at 7 percent. Assuming the maximum value of 1 is selected for CPFF contract risk, the contracting officer is limited to profit' levels well below the statutory limits of 15 percent for R&D CPFF contracts and 10 percent for other CPFF contracts. The high end of the range should be increased to allow the contracting officer to provide the statutory limit where performance risk merits the highest fee level.

2. 215.404-71-2 Technology Incentive – application of this incentive should not be limited to new system development and production. Commercialization initiatives that result in COTS insertion in critical defense items require a high degree of innovation to mitigate obsolescence risk, maintain high performance standards, and provide continual technology upgrades. Providing a high level of technology innovation through the life of the system will lower the total cost of ownership, and use of the Technology Incentive factor for superior life cycle support should be expressly allowed and encouraged.

3. 215.404-71-2 Management/Cost Control – use of contractor-furnished funds to begin effort in advance of contract funds should be rewarded rather than punished. Advancing funds to begin effort prior to receipt of a contract protects schedule, permits efficient material ordering, and provides continuity of workflow. DFARS 215.404-7 l-3 paragraph (d)(2) requires the contracting officer to assess the extent to which costs have been incurred prior to contract definitization and to reduce contract type risk to the low end of the range. This paragraph should be modified to be inoperative when the contractor furnishes funds for the purposes noted above, and additional profit for management/cost control risk should be allowed.

4. 215.404-71-4 Facilities capital employed – provide a means to credit modernization of computer/communications equipment and infrastructure when IT is outsourced. The current FCE calculation requires the assets to be on the contractor's books. This is increasingly not the case for contractors that recognize IT excellence can best be provided through outsourcing their IT departments.

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August 17, 1998

Mr. Bill Mounts
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Dear Mr. Mounts,

I want to thank you for the very informative meeting on civil-military integration held in July at General Dynamics in Falls Church, and to follow up on the brief discussion we had during the morning coffee break. I am very interested in reconciling commercialization of procurement with the existing DOD profit policy.

As you know, the current profit policy stated in DFARS Subpart 215.9 requires use of the weighted guidelines method, DD Form 1547. This regulation has not been revised for more than ten years. The last revision was to strongly link investment in capital equipment to profit.

In the years since capital investment was emphasized, the decline in defense procurement resulted in overcapacity and a subsequent wave of exits and mergers in the defense industrial base. The remaining companies focused on core competencies and outsourced the rest. COTS insertion was seen as the way to obtain shorter cycle times, increased performance, and affordable weapon systems.

This trend is counter to the incentive for capital investment. COTS components and processes are incentivized for production efficiency through the normal forces of competition in the commercial marketplace. Systems integrators no longer need in house electronic fabrication and the associated capital investment. Investment focus becomes “Intellectual Capital Employed” rather than “Facilities Capital Employed”.

I have a great interest in reconciling the profit policy with 90’s reality. As the Director of Contracts at General Dynamics Defense Systems, I am responsible for negotiated contracts with Strategic Systems Programs (SSP) for the Trident FBM Fire Control and Guidance development, production, and support. SSP is insistent on using weighted guidelines on every negotiated procurement.

In the last year we have shifted our focus from a multitude of manufactured components to systems and software integration. Major production activity was transferred from Pittsfield to other General Dynamics production facilities. Assembly, integration and test of FBM systems will continue in house, but fabrication and machining will be outsourced. We also outsourced our extensive Information Technology department, which involved transferring ownership of computing equipment to the outsourcing company to permit continual refreshing of technically obsolescent equipment. Of course, this removed the facilities capital for computing equipment from our books.

Commercialization and COTS insertion has removed facilities capital worth approximately $80M NBV from our books, while allowing us to improve performance and decrease the cost of our product. The latest generation of Fire Control is 48% of the cost in inflation-adjusted dollars of the last generation of Fire Control. Our reward is margin reductions of several points due to reduced facilities capital and the "formula" approach to profit dictated by weighted guidelines.

I have been searching in vain for a remedy. I have researched the Acquisition Deskbook, used the "Ask a Professor" feature, and posted a message to "The Water Cooler". In June we held a meeting of General Dynamics Contracts and Estimating leaders, and LeAntha Sumpter spoke on Acquisition Reform. I posed the question to her, and she responded based on her experience as a contracting officer. She suggested that the contracting officers would have to use some creativity in filling out the DD1547. Unfortunately, the apparent limit on creativity is the maximum values for performance risk and contract type, which are inadequate for the risks inherent in large system development and production even if a contracting officer were willing to use the maximum values.

It appears to me that the DOD profit policy is in need of an overhaul to continue motivating the commercialization process that we discussed at the July meeting. Can you suggest a person, or persons, responsible for policy in this area that could be approached? I am sure that others in industry share my concern, but I am unable to find government-industry dialogue in this area.

Again, I thank you for the insight on the important endeavor underway to commercialize DOD procurements. Any suggestions or assistance you can provide on the profit policy in this environment would be very much appreciated.

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